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Control No. 457115

Copy No. 25

EVALUATION OF THE STRATEGIC AND ECONOMIC SIGNIFICANCE OF
ITEMS ON THE DIFFERENTIAL INTERNATIONAL TRADE CONTROL LISTS
AGAINST COMMUNIST CHINA

CENTRAL INTELLIGENCE AGENCY

Office of Research and Reports

4 January 1956 (Revised)

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INTRODUCTION

A paper by CIA/ORR on "The Economic Impact of Differential International Trade Controls on Communist China", was issued on 27 December 1955. The conclusions from this earlier paper are summarized in Part A below. An additional consideration has been included on the economic effect of completely removing the special shipping controls against Communist China as well as the previously considered economic effect of reducing the trade control lists against Communist China to the level of control lists applied to the rest of the Bloc.

The significance of individual differential list items to the economy of Communist China is considered in Part B of this paper.

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Part A

The Economic Impact of Differential International Trade Controls on Communist China

With some few exceptions, items of Western origin on the differential lists are not denied Communist China because they can be procured by European Bloc countries and transshipped to Communist China. However, the differential control system does increase Communist Chinese transport costs because it denies Communist China the use of Western vessels and necessitates more costly rail shipments for the transport of goods which are on the differential lists even when the majority of such goods are of Soviet Bloc origin. It is currently estimated that the increased procurement and transportation costs to Communist China as a result of the differential trade embargo in 1955 totaled approximately US \$40 million. This estimate is based on the assumption that present special shipping controls on commodities embargoed to Communist China would be maintained even though the items on the CHINCOM control lists were reduced to the same level of controls applied by COCOM against the rest of the Bloc. It is believed that 25X6A proposal is for the reduction of the level of the CHINCOM embargo lists to the level of the COCOM control lists without an immediate change in the special shipping or voyage licensing controls. However, if the special shipping controls applied to trade with Communist China also were reduced to the type of shipping controls currently

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applied on trade with the USSR and Eastern Europe the saving in procurement and transport costs to Communist China as a result of relaxing both the differential embargo and special shipping controls would be over \$70 million instead of the \$40 million mentioned above. The higher saving results from the fact that relaxing special shipping controls against China to the type of shipping controls presently applied to the rest of the Bloc would permit the movement in Western ships of embargoed goods from Bloc ports to China. The saving to the Bloc of removing differential controls under the alternative assumptions concerning the special shipping controls is summarized in Table I.

In addition to the costs indicated in Table I, differential controls create certain delays and difficulties to the Communist Chinese in obtaining imports. In the case of high-priority goods these delays currently do not have a significant impact, as the Chinese have the alternate use of shipment by rail as well as determining the ship loading schedules. Current reports indicate no serious congestion at the transshipment port of Gdynia, although some low-priority goods may be subjected to minor delays. The effect of this can not be accurately estimated but it is thought to be minor.

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TABLE I

ESTIMATED SAVINGS TO THE SINO-SOVIET BLOC OF REMOVING DIFFERENTIAL
EMBARGO CONTROLS* -- 1955

	(Millions of \$US)	
	<u>Saving if Special Shipping Controls Maintained**</u>	<u>Saving if Special Shipping Controls also Removed</u>
<u>TO CHINA</u>		
Saving in Transport Costs	\$ 32	\$ 65
Premium Payments	<u>8***</u>	<u>8***</u>
TOTAL CHINA	\$ 40	\$ 73
<u>TO USSR</u>		
Saving in Transport Costs	58	85
<u>TO EUROPEAN SATELLITES</u>		
Saving in Transport Costs	<u>7</u>	<u>7</u>
TOTAL	<u>\$105</u>	<u>\$165</u>

* By far the largest part of the estimated costs are due to the increased costs of transporting POL overland because of the ban on the use of Western tankers. If it is assumed that the special shipping controls are maintained on goods embargoed to China even though the embargo is reduced to the European Bloc level, only crude petroleum could be transported in Western tankers. The present added cost of transporting crude petroleum overland is estimated at \$24 million in 1955. However, if all special shipping controls were removed, most POL products could be transported by Western tanker decreasing the cost of transport by \$82 million.

** An alternative estimate places the costs of the CHINCOM differential embargo at \$30 million to China and \$80 million to the Sino-Soviet Bloc. The variation in estimates is due solely to a judgment as to whether USSR crude petroleum from the Second Baku area is shipped to China via tank cars rather than tanker as a consequence of differential controls or as a practical means of moving crude. Soviet officials have stated that bulky cargoes should be shipped by sea wherever possible in order to reduce rail shipment costs; consequently the additional costs of moving crude overland to China from the Second Baku area have been included in the above table. It is estimated that China will probably produce enough domestic crude oil by the end of 1957 to employ fully available refining capacity and this item will no longer be significant.

*** See following "Note on Chinese Premium Price Payments in 1955."

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Note on Chinese Premium Price Payments in 1955

The additional cost incurred by the Chinese in 1955 due to the payment of premium prices is estimated at \$8 million. This includes a loss of foreign exchange from premium payments for the diversion and smuggling of controlled commodities of \$5 million, and a net premium paid to Ceylon of about \$3 million.

While the price paid Ceylon for rubber in the first 5 months of 1955 was below the world market price, due to an increase in the latter, Ceylon negotiated in mid-1955 for revision of prices under the trade agreement. China guaranteed to pay a progressively varying premium at different levels, beginning with 1 June 1955. On the basis of this new price system, it has been estimated (by U.S. Embassy Colombo) that the minimum "profit" to Ceylon upon the completion of the 1955 contract would total at least \$4.5 million.* With the softening of the rubber market in the fall of 1955, it is possible that this profit might exceed \$5 million. This estimated profit must be reduced to the extent of the premium Ceylon pays to China for rice. It is tentatively estimated that this premium may total \$2 million in 1955. Thus the net premium paid to Ceylon would amount to about \$3 million.

Note on Chinese Terms of Trade with Bloc Countries

On balance the terms of trade for the sale of Chinese goods to other Bloc countries is at least as favorable as those available in Western markets. Individual examples can, of course, be found where the terms of trade for the sale of Chinese goods in the Bloc were less favorable and also more favorable than terms which might have been obtained in the West.

* The embassy estimates 17.2 million rupees or \$4.5 million. However, a more realistic exchange rate would suggest \$3.6 million.

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Furthermore, Communist Chinese export earnings may be reduced as a result of the operation of CHINCOM controls.* The principal trading partner with whom this would be of some quantitative importance is Japan. It is estimated that during 1955 Chinese exports to Japan could have been from \$25-35 million greater without a significant diversion of resources from other commitments if Japan had been permitted to export to China goods under embargo. This continuing limitation on Communist Chinese exports to Japan, however, apparently results primarily from a Chinese political decision to limit exports to Japan because of Japanese adherence to the CHINCOM control system, and is not a necessary consequence of that system. Therefore, this reduction of Communist Chinese export earnings is not a direct cost imposed on China by the differential control system, although it is in a sense an effect of that system. Because it is not a direct cost, it is not included in the total of costs summarized in Table I above.

In summary, it is estimated that in the long run, neither the annual nor the cumulative cost of differential controls will significantly retard the development of the Chinese economy.

* The United States unilaterally prohibits the import of all goods from Communist China. The loss of Chinese export earnings resulting from United States import controls is estimated at approximately \$60 million in 1955. Also, the U.S. limitation on the transfer of remittances will result in a further loss of foreign exchange estimated at \$40 million during 1955. No country other than the United States maintains such controls.

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Part B

Individual Items on CHINCOM Differential Trade Control Lists

The individual items on the differential control list which consist of items on the consolidated China Special List and on International List II and III, have been reviewed utilizing the following criterion. The item must be of strategic and economic importance to Communist China and meet one of the two following conditions:

a. that the circumvention of the differential controls imposes a significant economic cost on Communist China, or

b. that the item while available to Communist China by transshipment from the West is in short supply in the Bloc.

Items under IL-II quantitative control to the USSR and Eastern Europe are assumed to meet criterion (b) above.

Not included in Annex A are the large number of differentially controlled items of varying degrees of strategic and economic importance to Communist China which are currently available to Communist China either from the rest of the Bloc or by transshipment from the West. Included in the differential control lists are approximately one hundred items which are of least strategic or economic importance to Communist China in terms of supply from the West. These items are listed in Annex B. Items listed in either Annex A or B for which the Japanese have expressed an interest in having removed from the control lists are indicated by an "X" placed in front of the number.

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DISCUSSION OF ITEMS ON DIFFERENTIAL CONTROL LISTS WHICH ARE IMPORTANT TO CHINA AND FOR WHICH THE CIRCUMVENTION OF CONTROLS IMPOSES A SIGNIFICANT ECONOMIC COST

1. Metal Working Machinery

<u>Item No.</u>	<u>Description</u>
I/L-2002	High precision (fine) boring machines, production types only, capable of an accuracy of 0.0005 inch (0.015 mm. or better).
I/L-2003	Horizontal combination boring, drilling, and milling machines (horizontal boring machines).
I/L-2052	Planing machines, planer milling machines, and combination planer and planer milling machines, with capacity for work pieces 48 inches up to but not including 72 inches wide.
I/L-2070	Forging hammers, as follows: (a) having a falling weight of 3 tons up to and including 6 tons, (b) steam, air or mechanical hammers of rated sizes 2.5 tons up to and including 5 tons.
I/L-2074	Forging machines as follows: (a) forging machines capable of operating on bar stock of a diameter exceeding 3.5 inches, (b) forging roll machinery.
I/L-3011	Internal cylindrical grinding machines, mechanical or hydraulic feed, production types only.
I/L-3012	Combined internal and external cylindrical grinding machines.
I/L-3018	Crankshaft, crankpin and camshaft grinders, with capacity for shafts 48 inches long or over.
I/L-3067	Metal cutting and working tools (not incorporating diamonds) for machine operations as follows: (a) broaching tools, (b) gear cutting tools, (c) forging roll sets.
I/L-3072	Presses, mechanical and hydraulic with rated pressures 1000 tons or less.

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Communist China has not attempted to procure the above machine tools, however, it is thought that she will attempt to procure them in the foreseeable future. These machine tools are tools used to manufacture other machine tools or machines. Production of these tools requires a long lead time and Bloc procurement of these tools from the Free World on behalf of China is not considered feasible. It is estimated that Chinese procurement of these tools will materially advance the Chinese industrial economy. Comments on each individual machine tool are listed below:

I/L-2002	None are known to be produced in China, and it is believed that they are in short supply in the Bloc.
I/L-2003	It is recommended this item be retained in sizes of 125 mm. and above. The Chinese are probably producing these machines in sizes to 110 mm.
I/L-2052	Not produced in China, and it is believed that they are in short supply in the Bloc.
I/L-2070	Overall Bloc shortage.
I/L-2074	Overall Bloc shortage.
I/L-3011	Not produced in China. Believed to be in short supply in the Bloc.
I/L-3012	Same as I/L-3011.
I/L-3018	Believed to be in short supply in the Bloc. Particularly useful in the construction and repair of small vessels suitable for coastal transport of materials and personnel.
I/L-3067	Believed to be in short supply in the Bloc.
I/L-3072	Overall Bloc shortage, except it is believed that for greatest strategic significance this item could be limited to presses with rated pressures of 500 to 1,000 tons.

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2. Chemical and Petroleum Equipment

1/L-2129 (C-131) Pump (except vacuum pumps and those pumps covered by Items 1131 (a) and 1131 (c) delivering liquids separately or in combination with solids and/or gases and having all flow contact surfaces made of 10 percent or more chromium or nickel.

1/L-2133 Pipe valves and cocks having all flow contact surfaces made of 10 percent or more chromium or nickel.

Transshipment from the European Soviet Bloc of the above equipment is not thought practical because this equipment is specially designed for specific purposes. Soviet Bloc production of above equipment is recognized, but it is considered to be in short supply, of inadequate quality, and lacking generally the technological advances attained in Western countries in recent years. Availability of non-Bloc made goods incorporating latest advances, fabricated from materials generally superior to those presently available in the Bloc, plus accessibility to ample stocks of spare parts, and technical advice, would materially assist Chinese accomplishment of industrial objectives in this area.

3. Electrical and Power Generating Equipment

C-266 Electrical power station equipment.

C-270 Turbines above 300 HP.

Much of the equipment defined by C-266 and C-270 is heavy and bulky, and difficult to transship. In addition, the problem of procuring and installing such technical equipment indirectly from the producer, through an intermediary, is often of such a magnitude as to become impractical.

The domestic supply of these items is entirely inadequate in China. Planned expansion of heavy industry is resulting in an increasing requirement for such commodities. Although Bloc producers offer occasional export of electrical generating equipment to non-Bloc customers, these products are still in general short supply, especially in some of the European Satellites. Despite this situation, China is dependent currently upon producers in the USSR and two or three of the European Satellites.

4. General Industrial Equipment

C-306 Tinning units, electrolytic - automatic continuous.

This item is not spelled out in List I but has been interpreted to fall into the category of rolling mill equipment. Electrolytic tinning lines are very difficult to manufacture and particularly to install. There is no electrolytic tinning line of the American type known to be installed anywhere within the Sino-Soviet Bloc. The USSR had on order two such lines from Davey-United, Ltd., but manufacture was stopped under the above interpretation. Availability of item C-306 would permit the Bloc to produce better tin plate and enable the saving of .5 to .75 lbs. of tin per base box produced.

5. Chemical and Petroleum Products

L/L-3768 Crude petroleum.

It is estimated that Communist China imported in excess of 200,000 tons of crude petroleum by rail from the USSR in 1955. If control of crude petroleum were discontinued, China could import crude by tanker at a saving of about 10 million over estimated current costs. There is no indication that the overland movement of crude from the "Second Baku Area"

to China would immediately cease. However, by the end of 1957 China will probably produce sufficient quantities of domestic crude oil to employ available refining capacity and the need for imported crude oil will therefore be greatly reduced.

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ADDITIONAL ITEMS, WHICH ALTHOUGH AVAILABLE TO COMMUNIST CHINA BY TRANS-SHIPMENT FROM THE WEST, ARE IN SHORT SUPPLY IN THE BLOC AS A WHOLE

1. Metals, Minerals and Their Manufactures

3652 Copper and copper-base alloy semifinished and finished products as follows:

- a. wire (uncovered)
- b. cable (uncovered)
- c. insulated wire (single strand conductor), of a diameter of 0.014 inch (0.35 mm.) or less.

It is obvious that the control on copper in other forms is being defeated by ordering copper in the form of wire. While intelligence estimates have not been completed, current indications are that the Bloc imported on the order of 65,000 tons of copper wire in 1955. Since copper in all forms is in critically short supply in Communist China, and since copper is vital to the expansion of its military and industrial potential, imports of wire and cable from the West will materially aid the carrying out of Communist China's plans for development.

2-605 - Transformer and choke laminations and core assemblies, a.e.s. made of the following materials:

- (1) Nickel and nickel base alloys
- (2) Electrical steel sheet or strip with a core loss of 0.59 watts per lb. (1.3 watts per kg.) or less at 10,000 gaussess and 50 cycles per second and with a thickness of 0.02 inch (0.5 mm.) or less.

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Although this item is partially covered on List I as item 1631, there is a difference in the definition of the electrical sheet. Item C-605 specifies a core loss of .59 watts per lb. or less at 10,000 gaussess, whereas item 1631 specifies a core loss of .5 watts per lb. or less at 13,000 gaussess. Both are top grade electrical sheets and very difficult to manufacture. It is believed that electrical sheets of these qualities are not now manufactured by any Bloc country.

2. Other Electronics and Precision Instruments

C-505 Coaxial electric cable of all types, n.e.s., suitable for the transmission of frequencies of 100 or more kilocycles per second.

Item C-505 is of strategic importance to Communist China. Under the definitions of IL-I Item 1525, a variety of "low-loss" types of cable are subject to embargo.

However, coaxial cables not covered by Item 1525 include a majority of the solid-dielectric radio-frequency cables as listed in our current Army-Navy Standard List, the total production of which is very significant as compared to the embargoed "low-loss" types.

The principle applications of such cables, as would be covered under C-505, are radar and military communications systems, particularly at the very high frequencies and above.

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It is reported that the Bloc production of all categories of coaxial cable has been, and continues to be, less than demand, with active attempts to import still continuing.

3. Transportation Equipment

(a) Motor vehicles and equipment as follows:

- (a) Motor vehicles n.e.s.
- (b) Chassis, components, and parts, n.e.s.
- (c) Servicing equipment and material n.e.s.

There exists a large vehicle park in China which is composed of U.S. vehicles taken over by Communist forces. There are indications that the greater portion of these vehicles that have not been scrapped or otherwise destroyed are inoperable because of a critical lack of spare parts. Essential electric components such as distributors, regulators and batteries are not available for these vehicles. Fuel pumps and carburetors are also in short supply.

Estimates on the size of the Communist Chinese motor park and the number of Western manufactured trucks and vehicles are not firm but there are indications that possibly as many as 10,000 vehicles of Western manufactures could be put into service if spare parts were freely available. Acquisition of these parts would allow the Chinese to reactivate these vehicles in a short time with a relatively small capital investment.

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It is impractical to embargo only spare parts for these vehicles. Also, China might welcome the opportunity to purchase Western type heavy duty 6-10 ton capacity trucks.

If this item were available from the West, China would probably shift a part of its procurement to the West or would try to expand total procurement of motor vehicles to include a supply from the West.

2415 - Other Vessels

Expansion of the merchant fleet is an important target of the Chinese Communist planning in the five-year period, 1953-1957. Present plans call for expansion of the ocean-going merchant fleet by at least 400,000 gross tons. This would increase the size of the present fleet by more than 100 percent. At the present rate of domestic construction, the Chinese Communists cannot nearly meet this target. Their only hope is acquisitions from outside sources. Domestic construction of large ocean-going merchant ships, excluding junks, is presently negligible. There is evidence of insufficient capacity in merchant shipping. For example, even though contrary to Chinese laws of cabotage, foreign merchant fleet vessels now transport a portion of China's domestic coastal trade. The use of foreign vessels is due largely to the Nationalist Blockade in the Formosa Straits area. If the Chinese Communists had more and better coastal vessels, however, it would be possible to circumvent the Blockade at least partly through the use of other shipping routes around Formosa. An increase in the Chinese tanker

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and dry cargo fleets would reduce, therefore, the cost of certain long haul traffic now carried on the rail system. In the past year, for example, it is known that cargoes have been hauled by rail all the way from Manchuria to South China and vice versa, apparently because of insufficient domestic tonnage of suitable quality for its transport. Although it is expected that initial acquisitions of merchant tonnage would be used for the coastal trade, China would also in time build up an ocean fleet for foreign trade. At present there is no capability in the China fleet to carry foreign trade.

2416 - Fishing vessels and hulls therefor.

3416 - Fishing vessels as specified.

Fishing vessels of the types included in 3416 and 2416 should be closely restricted because of the obvious utility in case of hostilities. Such tonnage acquired abroad could very easily be armed and used in case of war. The utility of the Japanese fishing fleet in World War II is one of the best proofs of the potential utility of a modern fleet of such vessels. It should be noted, furthermore, that the fishing vessels under consideration in this discussion are considerably different from the junk type vessels now being supplied by domestic construction.

3481 - Automatic (block type) railway signal systems.

This equipment permits an increase in the capacity of railroad lines which is far greater than would result from a similar investment in almost any other item of railroad equipment. The Soviet Union seems

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to have insufficient block signal equipment for its own needs. The only signals in China installed by the Communists to date are on the Peiping-Tientsin line and the Trans-Mongolia line; these were imported from the Soviet Bloc. It is not certain, however, that these signals are automatic block.

The significance of automatic block signals is indicated by a Soviet book on railroad transportation which states that the capacity of a double-track line with telegraph communications is up to 48 pairs of trains a day; but with automatic block signaling the capacity is increased up to 144 pairs a day (Khachaturov, Osnovy..., p. 338). The cost of installing automatic block signaling to obtain this significant increase in capacity is small compared with the installation of additional tracks to achieve a similar increase.

It is to be noted that China's railroads are now operating at high density, but that large increases in traffic are planned for the near future. The pressure for installation of automatic block signals, and the benefits to be derived from such installation will therefore increase.

4. Chemicals

3715 - Boric Acid and Borates

This commodity is currently being reviewed for possible up-grading to II-I because of its strategic significance. The supply in the Sino-Soviet Bloc is not believed to be adequate.

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